IN THE
SUPREME COURT OF THE UNITED STATES

October Term 1977

No. 77-842

JOHN P. DAVIS and
NINA J. DAVIS,

Appellants,

vs.

FRANCHISE TAX BOARD OF
THE STATE OF CALIFORNIA,

Appellee.

MOTION TO DISMISS OR AFFIRM

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Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Court of Appeal, for the following reason:

This case does not present a substantial federal question.

Introductory Statement and Summary of Argument

The California Supreme Court denied hearing in this matter and thus let stand the carefully considered opinion of the California Third District Court of Appeal

which is reported at 71 Cal.App.3d 998. The District Court of Appeal decision herein is in complete accord with the decisions of this Court and of the California Courts, and fully disposed of the arguments of appellants herein.

Appellants contend that California Revenue and Taxation Code [1] section 18243 violates rights protected under the Privileges and Immunities Clause of the United States Constitution (Art. IV, § 2, Cl. 1), since it denies income averaging to nonresidents but not to residents of California. Appellants contend that section 18243 is invalid under the reasoning set forth in this Court's decisions in *Travis* v. *Yale & Towne Mfg. Co.* (1920) 252 U.S. 60, 405 S.Ct. 228, 64 L.Ed. 460 and *Mullaney* v. *Anderson* (1952) 342 U.S. 415, 72 S.Ct. 428, 96 L.Ed. 458. Appellants contend that these decisions require the State to equate the additional burden placed on the nonresident taxpayer to the expense or burden on the taxing state.

It is respectfully urged that appellants have misread *Travis* and *Mullaney*. When read in their entirety it is apparent that these decisions stand only for the proposition that there must exist valid independent reasons for denying income averaging to nonresidents of California. The California income averaging residency requirements, as found by the California District Court of Appeal, *are* supported by valid and reasonable grounds which justify any resultant diversity of

[1] Hereinafter all references are to the California Revenue and Taxation Code unless otherwise specified.

treatment. The Court of Appeal found that the residency requirement insures parity of treatment between persons with fluctuating incomes, the very objective of income averaging. Facility of administration is also enhanced by the requirement, which is an additional ground justifying any difference in treatment which may result from the income averaging residency requirements. Furthermore, the effect of the possible discrimination is no more onerous with respect to nonresidents than residents, e.g., if any resident has been in the state for less than the full five year period he too may not use the income averaging method.

ARGUMENT

I

INTRODUCTION

For the reasons relied upon by the California Court of Appeal, plus those further detailed below, any diversity of treatment occasioned by the California income averaging residency requirements does not infringe upon the Privileges and Immunities Clause as interpreted by this Court.

II

CALIFORNIA INCOME AVERAGING PROVISIONS

California's income averaging provisions are optional

(§ 18244[a]) and are contained in sections 18241 through 18246. The purpose of the income averaging provisions is set forth in the California Administrative Code, as follows:

> "In effect, these sections generally treat the income as having been included in gross income ratably over the years (preceding receipt or accrual) in which it was earned. However, these sections have no effect on the income tax liability for prior taxable years; they simply provide a special method of computing the amount of tax for the year of receipt or accrual." 18 Cal.Admin.Code § 18241 (a).

Since appellants were nonresidents during a portion of one base year (September 1972 through December 31, 1972) and for the entire computation year of 1973 (§ 18242 [d]), section 18243 expressly prevented them from using the income averaging method.

III

THIS CASE DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION REQUIRING THIS COURT'S REVIEW

A. The California Income Averaging Residency Requirements are Enacted As A Valid Exercise of the Legislature's Right of Classification and Are Not in Violation Of the Privileges and Immunities Clause Of the United States Constitution

1. This Court's Interpretation of The Privileges and Immunities Clause Does Not Mandate Precise Equality of Taxation Between Residents and Nonresidents

Appellants assert that California's residency provisions infringe rights guaranteed them by article IV, section 2, clause (1) of the United States Constitution, the Privileges and Immunities Clause, which states in pertinent part the following:

> "The citizens of each State shall be entitled to all privileges and immunities of citizens in the several States."

It should be emphasized preliminarily that when resolving constitutional challenges to state tax measures, this court has made it clear that "in taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Austin* v. *New Hampshire* (1975) 420 U.S. 656, 95 S.Ct. 1191, 1195, 43 L.Ed.2d 530; *Madden* v. *Kentucky* (1940) 309 U.S. 83, 60 S.Ct. 406, 408, 84 L.Ed. 590; See also *Christman* v. *Franchise Tax Bd.* (1976) 64 Cal.App.3d 751, 762. In addition, "The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it." *Madden* v. *Kentucky, supra,* 309 U.S. 83, 88, 60 S.Ct. 406, 408, 84 L.Ed. 590; *Richfield Oil Corp.* v. *Franchise Tax Bd.* (1959) 169 Cal.App.2d 331, 335–336.

This Court has made it emphatically clear that the Priviliges and Immunities Clause is not an absolute. In the case of *Toomer* v. *Witsell* (1948) 334 U.S. 385, 68 S.Ct. 1156, 92 L.Ed. 1460, the Court said:

> "Like many other constitutional provisions, the privileges and immunities clause *is not an absolute.* It does bar discrimination against citizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are

citizens of other States. *But it does not preclude disparity of treatment* in the many situations *where there are perfectly valid independent reasons for it.* Thus the inquiry in each case must be concerned with whether such reasons do exist and whether the degree of discrimination bears a close relation to them (footnote omitted). *The inquiry must* also, of course, *be conducted with due regard for the principle that the States should have considerable leeway in analyzing local evils and in prescribing appropriate cures.*" (Emphasis added.) *Toomer, supra,* 334 U.S. 385, 396. *See also, Addison* v. *Addison* (1965) 62 Cal.2d 558, 568–569.

Recent cases have continued to recognize that the Privileges and Immunities Clause is not an absolute. In *Montgomery* v. *Douglas* (1974) 388 F.Supp. 1139, affirmed (1975) 422 U.S. 1030, 95 S.Ct. 2645, 45 L.Ed.2d 687, the Court upheld as constitutional Colorado's twelve-month domiciliary tuitional requirement, stating the following:

"Colorado has reasonably attempted through its legislation to distinguish those students who sincerely intend to remain in Colorado from those who do not in order to give the former the opportunity to attend its institutions of higher learning on a subsidized tuition basis. . . .

"The statute is also reasonably related to the legitimate interest of the state in ensuring that those who pay in-state tuition rates have made and will make some contribution to the state before entitlement to in-state student status." *Montgomery* v. *Douglas, supra,* 388 F.Supp. 1139, 1146, affirmed on appeal, 422 U.S. 1030, 95 S.Ct. 2645, 45 L.Ed.2d 687.

See also American Commuters Association v. *Levitt* (C.A.N.Y. 1969) 405 F.2d 1148 and *Kirk* v. *Regents of University of California* (1969) 273 Cal.App.2d 430; appeal dismissed, (1970) 396 U.S. 554, 90 S.Ct. 754, 24 L.Ed.2d 747.

The case of *Austin* v. *New Hampshire, supra,* (1975) 420 U.S. 656, 95 S.Ct. 1191, 43 L.Ed.2d 530, which held the New Hampshire Commuter's Income Tax unconstitutional, was a case where there simply was no independent basis whatsoever for the discrimination between residents and nonresidents. Such is not the case, as will be discussed below, with respect to California's income averaging residence requirements. *See also, Pennsylvania* v. *New Jersey* (1976) 426 U.S. 660, 96 S.Ct. 2333, 49 L.Ed.2d 124.

2. Valid and Reasonable Grounds Justify Any Diversity of Treatment Occasioned by the Residency Requirement of Section 18243.

(a) Introduction.

Since California's income averaging law was modeled on similar federal provisions (see Int. Rev. Code of 1954, §§ 1301–1305; 26 U.S.C. 1301 et. seq.), the federal legislative purpose is pertinent in determining the California Legislature's purpose in enacting nearly identical statutes. *Innes* v. *McColgan* (1941) 47 Cal.App.2d 781, 784; *Union Oil Associates* v. *Johnson* (1935) 2 Cal.2d 727, 734–735.

Federal legislative intent relative to the general reasons for enactment of income averaging legislation has been explained as follows:

"A general averaging provision *is needed to accord those whose incomes which fluctuate widely from year to year the same treatment accorded those with relatively stable incomes.* Because the individual income tax rates are progressive, over a period of years those whose incomes vary widely from year to year pay substantially more in income taxes than others with a comparable amount of total income but spread evenly over the years involved. This occurs because the progressive rates take a much larger proportion of the income in taxes from those whose incomes in some years are relatively high. . . .

". . . . . .

"Income averaging in your committee's view, should be designed to treat everyone as nearly equally for tax purposes as possible, without regard to how their income is spread over a period of years and without regard to the type of income involved. At the same time, *it is necessary to have any income averaging device in a form which is workable,* both from the standpoint of the taxpayer and the Internal Revenue Service." (Emphasis added.) House Report No. 749, 88th Cong. 2d Sess. (1963), Vol. 1, 1964 U.S. Code Cong. & Ad. News, pp. 1418–1419.

The following explanation of the federal eligibility requirements appears in the House report:

"*To be eligible for averaging, one of the principal concerns is that the individual's income must have been subject to tax by the United States throughout the entire base period as well as the computation year.* No one is eligible for averaging who was a nonresident alien in any of the 4 base period years or in the computation year. *In addition, even though a citizen in the computation year, the individual must*

be claiming no exclusion in that year for income earned abroad . . . .

"*A second concern* of this provision *is that the individual be a member of the labor force* in both the computation year and in the 4 base period years. . . ." (Emphasis added.) House Report No. 749, 88th Cong., 2d Sess. (1963), Vol. 1, 1964 U.S. Code Cong. & Ad. News, p. 1428; *see also* Senate Report No. 830, 88th Cong., 2d Sess. (1963), Vol. 1, 1964 U.S. Code Cong. & Ad. News, p. 1818.

The same purpose and concerns were necessarily also adopted by the California Legislature in enacting similar provisions.

(b) *Insuring the Parity of Treatment Sought by Income Averaging*

Although California residents and nonresidents are subject to the same graduated tax rates, the tax brackets applicable to the latter are determined only by income from sources within California. § 17041. The personal income tax law restricts the nonresident's gross income to that derived from California sources. § 17951. Thus, California has chosen to ignore out-of-state income in finding a nonresident's tax bracket. Unlike a resident, the nonresident receives the benefit of a tax bracket which is not proportioned to his total ability to pay.

As pointed out above (III-A-2(a)), parity of treatment is the objective of the income averaging option. Absent the residency requirement, this objective of parity would be completely eliminated. The California Court of Appeal in this case quite properly found this possible consequence alone to be a sufficient independent

reason for sustaining the residency requirement. The court stated in pertinent part the following:

> "In order to invoke income averaging, a resident taxpayer must display his entire, five-year income history. The nonresident need not. If income averaging were available to him, the nonresident could display a fluctuating California income as a cloak for non-fluctuating total income. He could lawfully relegate his non-California, base-period income to silence, even when it is high enough to reduce or eliminate its disparity with current, computation-year income. He could exhibit an inflated, computation-year California income even though his total income had not increased. Income averaging is optional. A nonresident taxpayer's ability to isolate his California income for averaging would provide him more options than a resident taxpayer. His need for the parity of treatment sought by income averaging remains unknown, for he need not show foreign, nontaxable income. The latter may nullify his equitable entitlement to income averaging.
> "
> . . . . . .
> "The nonresident isolates his California income for the purpose of finding his tax bracket. Ability to indulge in income averaging would multiply his opportunities to find a tax bracket ill suited to the goal of tax parity. Superimposed upon California's system of ignoring the non-resident's out-of-state income, averaging would permit him to distort his five-year income history; simultaneously it would deny the state the means of discerning between real and fictitious fluctuations. These factors provide a valid reason, independent of the mere fact of

> nonresidency, for denying income averaging to nonresidents." 71 Cal.App.3d 998, 1003, set forth in Appellants' Jurisdictional Statement, Appendix, pp. vi-vii.

It is clear that such preferential treatment for nonresidents is not required by the Constitution. See *Shaffer* v. *Carter* (1920) 252 U.S. 37, 53, 40 S.Ct. 221, 64 L.Ed. 445.

(c) *Facilitating Administration.*

In California, residency for the requisite five years also facilitates the administration of the income averaging law since appellee is in a much better position to ascertain and verify pertinent facts such as income earned, marital status, support received, etc., with respect to its own residents than for nonresident individuals. *See Maxwell* v. *Bugbee* (1919) 250 U.S. 525, 542-543, 40 S.Ct. 2, 63 L.Ed. 1124.

In that regard, it is noteworthy that respondent's investigative subpoena power (§ 19254; Cal. Gov. Code § 11181(e)), and administrative collection powers of Order to Withhold (§ 18817) and warrant (§ 18906), do not extend beyond California's borders. Cal. Gov. Code §§ 200 and 270. Liens recorded or filed by appellee likewise apply only to property within California. § 18881 et seq.

In the case of *Madden* v. *Kentucky, supra,* 309 U.S. 83, 60 S.Ct. 406, 84 L.Ed. 590, this Court found that ease of collection warranted an *ad valorem* tax on residents with deposits in banks outside the State of Kentucky at a rate five times that on deposits in banks located in the

state. Although deposits in out-of-state banks by residents of Kentucky would obviously be thereby discouraged, it was found that the ease of collection warranted the distinction.

(d) *Assuring That Taxpayer Was Member of State Labor Force*

Finally, the residency requirement finds justification in the fact that it makes it much more likely that the taxpayer was a member of the labor force and therefore a taxpayer and contributor to the state's economy. See *Kirk* v. *Regents of University of California, supra,* (1969) 273 Cal.App.2d 430; appeal dismissed, (1970) 396 U.S. 554, 90 S.Ct. 754, 24 L.Ed.2d 747; and 18 Cal.Admin.Code §§ 17014–17016(b).

3. Appellants' Arguments Have Been Raised and Properly Rejected, There Being Valid Reasons Independent of Nonresidence For Denying Income Averaging to Nonresidents of California

In support of appellants' contention that section 18243 violates the Privileges and Immunities Clause *Travis* v. *Yale & Towne Mfg. Co., supra,* 252 U.S. 60, 40 S.Ct. 228, 64 L.Ed. 460 and *Mullaney* v. *Anderson, supra,* 342 U.S. 415, 418, 72 S.Ct. 428, 96 L.Ed. 458 are erroneously cited for the proposition that a law may be found unconstitutional unless the expense or burden placed on the taxing state is equated to the additional burden placed on the nonresident taxpayer. These decisions instead stand only for the proposition that there must exist valid independent reasons for denying income

averaging to nonresidents of California.

Mullaney relied upon *Toomer* v. *Witsell,* elaborated upon above at III-A-1, in establishing the guidelines for applying the Privileges and Immunities Clause. The Court's holding, quoted in context, is as follows:

> *"Constitutional issues affecting taxation do not turn on even approximate mathematical determinations.* But something more is required than bald assertion to establish a reasonable relation between the higher fees [to nonresident fishermen] and the higher cost to the Territory. *We do not remotely imply that the burden is on the taxing authorities to sustain the constitutionality of a tax.* But where the power to tax is not unlimited, validity is not established by the mere imposition of a tax. In this case, respondents negatived other possible bases raised by the pleadings for the discrimination, and the one relied on by the Commissioner, higher enforcement costs, was one as to which all the facts were in his possession. Respondents sought to elicit these facts by interrogatories and cross-examination without avail. Under the circumstances we think they discharged their burden in attacking the statute." (Emphasis added.) *Mullaney* v. *Anderson, supra,* 342 U.S. 415, 72 S.Ct. 428, 96 L.Ed. 458.

In this case appellee has established that reasonable grounds exist which justify any resultant diversity of treatment. Appellant has entirely failed to negative any of the grounds set forth. *Mullaney* therefore does not add support to appellants' position. It is apparent that *Mullaney,* similar to the "commuter" tax cases *(Austin* v. *New Hampshire, supra,* 420 U.S. 656, 95 S.Ct. 1191, 43

L.Ed.2d 530), was a case where the state's primary objective was taxation of nonresidents at a higher level than that for residents. This offends the principle of comity imbedded in the Privileges and Immunities Clause. The California income averaging residency requirements, on the other hand, as properly found by the California Court of Appeal, are supported by valid and reasonable grounds which justify any resultant diversity of treatment.

IV
CONCLUSION

In conclusion, there are valid independent reasons which justify the California residency requirements for income averaging, thus complying with the Privileges and Immunities Clause. Insuring the parity of treatment sought by income averaging, as found by the Court of Appeal, is alone sufficient justification. In addition, facility of administration is a reasonable ground for any discrimination which may result from the income averaging residency requirements. Furthermore, the effect of the possible discrimination is no more onerous with respect to nonresidents than residents, e.g., if any resident has been in the state for less than the full five-year period he too may not use the income averaging method.

On balance, California's residency requirements for income averaging purposes are an equitable exchange for the privilege of income averaging and do not infringe upon appellants' constitutional privileges and

immunities, which constitutional right is not absolute. To eliminate the residency requirements would grant certain taxpayers who were nonresidents during a portion of the base or computation periods a distinct advantage over similarly situated resident taxpayers. Such a result, of course, is not dictated by the United States Constitution.

Based on the foregoing, it is respectfully urged that this Court dismiss appellants' appeal, there being a failure to present a substantial federal question as required by Rules 15 and 16 of the Rules of the Supreme Court of the United States, or, in the alternative, affirm the decision of the California Court of Appeal.

Respectfully submitted,

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